(3)

No. 03-1018

In the Supreme Court of the United States

STATE CONCERN TURKMENNEFT,

Petitioner,

v.

BRIDAS S.A.P.I.C.; BRIDAS ENERGY INTERNATIONAL, LTD.; INTERCONTINENTAL OIL & GAS VENTURES, LTD.; BRIDAS CORPORATION,

Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

REPLY TO BRIEF IN OPPOSITION

WILLIAM H. KNULL, III
TIMOTHY J. TYLER
Mayer, Brown, Rowe & Maw LLP
700 Louisiana Street
Houston, TX 77002
(713) 221-1651

JEFFREY W. SARLES
Counsel of Record
WILLIAM H.J. HUBBARD
Mayer, Brown, Rowe & Maw LLP
190 South LaSalle Street
Chicago, IL 60603
(312) 782-0600

Attorneys for Petitioner

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REPLY TO BRIEF IN OPPOSITION

Respondents do not deny a circuit conflict over the meaning and scope of the manifest disregard of law standard of review. Instead, they attempt to narrow it to a conflict between the Seventh Circuit and the other circuits and contend that it is irrelevant to this case. As demonstrated below, the circuits are deeply divided over this important issue of federal law, and petitioner would prevail under the proper standard.

Respondents admit (at 5) that the discount rate selected by the arbitrators was the same rate that the parties' joint venture agreement specified for the short-term FPC loan. Instead of trying to explain how a rate appropriate for secure short-term debt could possibly be appropriate for risky long-term equity, they dismiss this logical impossibility as an issue of fact. But the arbitrators could not have made such an inherently contradictory ruling—and then refused to correct it after being made aware of it—without disregarding the *law* requiring that a discount rate reflect repayment risk.

I. The Lower Courts Are Deeply Divided Over The Meaning Of Manifest Disregard Of The Law.

1. Respondents' contention (at 10) that petitioner waived its right to raise this conflict by failing to do so below is bizarre. A circuit conflict is a ground for granting a petition for certiorari (S. Ct. Rule 10), not a ground for reversal in the court of appeals. Petitioner therefore had no reason to raise the circuit conflict to the Fifth Circuit. This Court never has suggested that a party must raise a circuit conflict in the court of appeals to preserve its right to petition for certiorari.

2. The petition (at 7-12) demonstrates the recognition of courts and commentators that the lower courts are in disarray over the meaning and scope of the manifest disregard of law standard. Respondents (at 10-11) say this is the view of but a "handful" of students. But D.C. Circuit Judge Edwards notes

that "manifest disregard of the law [has] not been defined by the Court, and the circuits have adopted various formulations." *Where are We Heading with Mandatory Arbitration of Statutory Claims in Employment?*, 16 Ga. St. U. L. Rev. 293, 303 (1999). Judge Easterbrook agrees that the understanding of "manifest disregard" by his own and "other circuits" has been "confused." *George Watts & Son* v. *Tiffany & Co.*, 248 F.3d 577, 580 (7th Cir. 2001) (attributing confusion to this Court's "opaque" dictum). And Professor William Park recently contrasted the "restrictive view" of manifest disregard espoused by some courts with the "expansive view" of others. *The Specificity of International Arbitration*, 36 Vand. J. Transnat'l L. 1241, 1250 (2003).

Similar commentaries abound. In addition to those cited in the petition, see Albert Besser, *The Arbitrator Blew It! Now What?*, 29 Vt. B.J. 39, 42 (Summer 2003) (courts "flip and flop" over manifest disregard); Michael Landrum & Dean Trongard, *Judicial Morphallaxis: Mandatory Arbitration and Statutory Rights*, 24 Wm. Mitchell L. Rev. 345, 376 (1998) (noting "uncertainty" among courts about meaning of manifest disregard); Kenneth Davis, *The Arbitration Claws: Unconscionability in the Securities Industry*, 78 B.U. L. Rev. 255, 306-307 (1998) (noting "controversy among the federal courts" over meaning of manifest disregard); Julian Moore, Note, *Arbitral Review (or Lack Thereof)*, 100 Colum. L. Rev. 1572, 1586 (2000) ("lower courts continue to debate the validity and scope of this judicial standard"); Victoria Holstein, *Co-Opting the Federal Judiciary*, 12 World Arb. & Mediation Rep. 276, 284 (2001) (urging this Court to "articulate a cogent, workable standard" for a "meaningful application" of the manifest disregard standard "by the lower federal courts").

3. This widely recognized circuit conflict has not been "manufacture[d]" by petitioner, as respondents contend (at 19). Although respondents assert that all circuits other than the Seventh adhere to the same standard, their string cite of

cases (at 13 n.9) purporting to support this proposition actually *confirms* the deep division among the circuit courts.

Respondents' cited cases differ over whether an arbitrator's disregard must be deliberate to warrant vacatur. Some require that the arbitrator "refused" to heed the law. *Nationwide Mut. Ins. Co.* v. *Home Ins. Co.*, 330 F.3d 843, 847 (6th Cir. 2003). Others say the award need only be "irreconcilable" with the law (*Advest, Inc.* v. *McCarthy*, 914 F.2d 6, 10 (1st Cir. 1990)) or that the arbitrator "proceed[ed] to ignore it" (*Schoch* v. *InfoUSA, Inc.*, 341 F.3d 785, 788 (8th Cir. 2003)). Some authorize vacatur where the arbitrators *either* "refused" to apply the law *or* simply "ignored" it. *Banco de Seguros* v. *Mut. Marine Office, Inc.*, 344 F.3d 255, 263 (2d Cir. 2003); *LaPrade* v. *Kidder, Peabody & Co.*, 246 F.3d 702, 706 (D.C. Cir. 2001). Still others merge intent and negligence into a "willful inattentiveness" standard. *Sheldon* v. *Vermonty*, 269 F.3d 1202, 1207 (10th Cir. 2001). Thus, respondents are plainly wrong when they assert (at 19) that "all of the circuits" require a "knowing or intentional" disregard of the law. Respondents' cases reflect other differences as well. One requires that the arbitrator "correctly state the law" (*Upshur Coals Corp.* v. *United Mine Workers*, 933 F.2d 225, 229 (4th Cir. 1991)), while another requires only that the law be "well defined, explicit, and clearly applicable" (*Prestige Ford* v. *Ford Dealer Computer Servs., Inc.*, 324 F.3d 391, 395 (5th Cir. 2003)).

4. Respondents attempt to collapse all this variation into what they call (at 1, 2, 16, 17) a "traditional test"—"the arbitrator understood the existence of a governing legal principle but decided to ignore it." But some of respondents' cases apply very different tests. One says an award manifestly disregards the law if it is "legally irreconcilable with the undisputed facts." *Coutee* v. *Barington Capital Group, L.P.*, 336 F.3d 1128, 1133 (9th Cir. 2003). Another equates manifest disregard with "arbitrators' gross misconduct." *Flex-Foot, Inc.* v. *CRP, Inc.*, 238 F.3d 1362,

1366 (Fed. Cir. 2001). Neither comports with the purported "traditional test." Further, respondents admit that at least one circuit in addition to the Seventh recognizes a non-traditional test for manifest disregard, authorizing vacatur where the award "is contrary to the plain language of the contract." Opp. 21-22, citing *Wonderland Greyhound Park, Inc.* v. *Autotote Sales, Inc.*, 274 F.3d 34, 36 (1st Cir. 2001).

Respondents (at 21) cannot squeeze *Montes* v. *Shearson Lehman Bros.*, 128 F.3d 1456, 1459 (11th Cir. 1997), or *Halligan* v. *Piper Jaffray, Inc.*, 148 F.3d 197 (2d Cir. 1998), into their "traditional test." In *Montes*, as respondents note (at 21), the arbitrators were urged to deviate from the law, but nothing indicates they in fact did so as required under respondents' "traditional" test. *Halligan* does not suggest the arbitrators knew of the law they disregarded. As Judge Edwards observes, "there was no legal error identified"; "the court simply found the evidence of discrimination so overwhelming [that] it could only have been the product of manifest disregard of the law, the evidence, or both." Edwards, *supra*, at 306. The difficulties that a later Second Circuit panel had in explaining the manifest disregard analysis in *Halligan* (Opp. 20) simply underscore the continuing confusion over this issue. For example, in a recent decision, the court initially described the standard as *objective*, based on the perception of an "average person qualified to serve as an arbitrator," and then as *subjective*, requiring that the arbitrator "*knew* of the governing legal principle but chose to ignore it." *Huntington Hosp.* v. *Huntington Hosp. Nurses' Ass'n*, 2004 WL 291956, at *5 (E.D.N.Y. Feb. 10, 2004) (emphasis added).

The lower courts' differing approaches have practical consequences for parties contemplating arbitration. Companies operating in different regions of the country should not face different odds on judicial review depending on where the action is filed. Respondents' contention that this conflict is diminishing is refuted by their own

recognition (at 15, 17) that "the Seventh Circuit *recently* adopted a *new*, very stringent standard for manifest disregard" in conflict with the standards of "all other circuit courts." Respondents (at 17) downplay this evidence of a sharpening split by stating that adoption of the Seventh Circuit's standard "would not change the outcome in this case." But petitioner need not show that it would prevail under each of the standards offered by the circuit courts. It is enough to show the significant conflict over this important federal question, note that only this Court can establish a uniform standard, and recognize that petitioner should have an opportunity to make its case under the proper standard.

II. The Award Cannot Stand Under The Proper Standard.

1. Respondents (at 23) say this case presents "no live case or controversy" because the awarded discount rate would be upheld under any manifest disregard standard. But it is premature to determine which party will prevail on the merits. The issue at this stage is whether the question presented is certworthy. If the courts are divided over an important issue of federal law, as we have demonstrated, this Court may appropriately use this case to resolve it.

2. Furthermore, petitioner *would* prevail under a number of standards adopted by the courts of appeals. The award at issue is "legally irreconcilable with the undisputed facts," the test in *Coutee*, 336 F.3d at 1133, because it is mathematically certain that using a short-term secure debt rate to discount a long-term risky revenue stream from the same enterprise will inflate value beyond actual damages. The award thus rests "on reasoning so palpably faulty that no judge [could] conceivably have made such a ruling," the test in *Prudential-Bache* v. *Tanner, Inc.*, 74 F.3d 234, 238 (1st Cir. 1995), because no judge would order such a palpably inapplicable discount rate and thereby inflate damages by $200 million. Further, the award is "contrary to the plain language of the

contract," the test in *Wonderland*, 274 F.3d at 36. The joint venture agreement not only designated the 10.446% rate for a short-term and secure loan, but also barred "consequential, punitive or other similar damages." RE12 at 6339. Contrary to respondents' assertion (at 22), petitioner consistently has sought to vacate the award on this basis because the ordered discount rate multiplied actual damages. See Pet. 19.

3. Petitioner also would prevail under the standard it urges here, which would authorize modification or vacatur of an award that egregiously departs from established legal principles. Pet. 13-14 (awards should be vacated for "extreme deviations from governing law" to prevent "unwarranted windfalls"). Courts and commentators have recognized that such a standard would ensure the integrity of the law while maintaining the advantages of arbitral resolution. See *Garrity* v. *McCaskey*, 612 A.2d 742, 747 (Conn. 1992) (defining manifest disregard as an "extraordinary lack of fidelity to established legal principles") (Peters, C.J.); Norman Poser, *Judicial Review of Arbitration Awards: Manifest Disregard of the Law*, 64 Brook. L. Rev. 471, 513 (1998).

This standard would address this Court's insistence that agreeing to arbitrate merely selects a forum and does not surrender "substantive rights." *Gilmer* v. *Interstate/Johnson Lane Corp.*, 500 U.S. 20, 26 (1991); accord *Mitsubishi Motors Corp.* v. *Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 628 (1985); *Shearson/Am. Express Inc.* v. *McMahon*, 482 U.S. 220, 229-230 (1987). Agreeing to arbitrate *would* risk a surrender of substantive rights unless a court may correct extreme deviations from governing law. This Court also has insisted that, with respect to federal statutory claims, judicial review must be "sufficient to ensure that arbitrators comply with the requirements of the statute at issue." *Gilmer*, 500 U.S. at 32 n.4, quoting *McMahon*, 482 U.S. at 232. Such meaningful review is needed to ensure compliance with *any* governing law applicable to the parties' dispute, whether or not its source is a federal statute. As the D.C. Circuit has

explained, ensuring that arbitrators adhere to law to the same extent as courts requires a "manifest disregard of the law standard [that] is sufficiently rigorous." *Cole* v. *Burns Int'l Sec. Servs.*, 105 F.3d 1465, 1487 (D.C. Cir. 1997).

Further, the proposed standard would comport with the contractual basis of arbitration. Parties agreeing to arbitrate presumably do not contemplate an award egregiously at odds with established law. Such a standard also reflects how some courts have handled manifest disregard challenges in practice. *Halligan*, *Montes*, and other cases recognize that, notwithstanding the high level of deference accorded to arbitrators, courts must have the authority to overturn awards that egregiously flout the law. Such a standard remains narrow, indeed considerably narrower than the scope of review applied to trial court judgments. As Professor Poser has observed, this is a "workable standard that represents an acceptable balance between the finality that is an important goal of arbitration and the accuracy and fairness that are fundamental to the rule of law." Poser, *supra*, at 518.

4. The confusion plaguing the lower courts involves more than how to *articulate* the proper test. Whatever the formulation, the standard must be meaningfully *applied* to rein in outlandish departures from the law. Guidance is needed from this Court, which has never explained how to apply the manifest disregard standard it originated, to ensure that it is applied properly and uniformly. For example, respondents' "traditional test" does not tell a court how to tell whether "the arbitrator understood the existence of a governing legal principle" nor whether he "decided to ignore it." Must an arbitrator expressly state that he knows the law but will not apply it? If so, indefensible awards will escape meaningful review because only a foolish arbitrator would make such a statement. Or can manifest disregard be inferred from the award and the arbitral submissions? How should a court determine whether disregard of the law was deliberate? If that requirement is too stringent, arbitrators that flout the

law will be sustained simply because they keep their reasoning hidden. These questions need answers to prevent gross and intolerable departures from governing law.

Application of this standard should not depend on showing that the arbitrator *knew* the law, as respondents insist (at 19-20) and some courts continue to hold. See *Shanghai Foodstuffs Import & Export Corp.* v. *International Chem., Inc.*, 2004 WL 213019, at *3 (S.D.N.Y. Feb. 4, 2004) (requiring "acknowledgment by the arbitrators" of applicable law). It is unrealistic to require parties or expect courts to establish such knowledge because, without a written opinion, courts would have to "work backwards from the result reached in the arbitration." Stephen Hayford, *A New Paradigm for Commercial Arbitration*, 66 Geo. Wash. L. Rev. 443, 469 (1998). Moreover, a knowledge-of-the-law requirement would encourage proliferation of legal arguments and citations to preserve this ground for review. Such formalism would undermine the speed and economy promised by arbitration and unduly complicate judicial review proceedings. It also would encourage arbitrators "not to find out what the law is." Poser, *supra*, at 515. An extreme deviation from clear and established law should be subject to vacatur regardless of the arbitrator's subjective knowledge.

Nor should a "deliberate" refusal to apply the law be required. Not only would proving an arbitrator's intent be impractical and unduly complicate judicial review, but nothing in the term "manifest disregard" requires such intent. "Manifest" means "obvious to the understanding." BLACK'S LAW DICTIONARY 962 (6th ed. 1990). "Disregard" means "take no notice of" or "ignore" or "overlook." *Id.* at 472. Hence, so long as the arbitrator ignored obvious legal principles, an award should be subject to modification or vacatur for manifest disregard of the law.

5. Adoption of a meaningful standard will not undermine arbitral finality. Mere disagreements with an

arbitrator's legal interpretation will remain insufficient. The "vast majority" of arbitrations hinge on factual findings. Edwards, *supra*, at 304. Where the law is disputed, "the best way to ensure that an arbitral forum is neutral, fair, and legitimate is to allow meaningful judicial review." *Id.* at 302. Armed with this understanding, courts would be less hesitant to ensure arbitrators' fidelity to the law. In this case, the court of appeals may well have reached a different result, even under its articulated test, if it had understood that the "high degree of deference" to arbitrators (Pet. App. 26a) did not bar it from finding that a legally impermissible and logically contradictory discount rate manifestly disregarded the law.

6. Respondents assert (at 27) that petitioner identified "no law" because it stated to the arbitrators that no English "breach of contract" cases specifically address determination of a discount rate. But the very next sentence in petitioner's brief to the arbitrators explained that other English cases *do* address that issue. For example, a property rights case, *Dir. of Buildings & Lands* v. *Shun Fung Ironworks Ltd.*, 2 A.C. 111, 132 (P.C. 1995), addressed the proper discount rate to determine "[t]he present value of a stream of profits expected over a period of years." In the course of evaluating competing discount rate proposals, the court explained that "[t]he greater the risk" the recipient "may not receive in due course the future payments," the "higher the rate of return he will require." *Ibid.* Petitioner consistently has relied on *Shun Fung* and other English authorities to show that a discount rate must reflect the relative risk of nonrecovery and that discounting a revenue stream by a rate applicable to a stream of lesser risk is mathematically certain to provide a windfall rather than the actual damages required by English law. See Pet. 16. Respondents ignore these authorities and do not cite a single English case. Like the arbitrators, they disregard legal principles that preclude use of the same rate both to discount long-term/risky equity and to finance short-term/secure debt.

Respondents' charge (at 28) that there is no evidence of "disregard" also is inaccurate. As the petition explains (at 3-4, 19-20), the arbitrators boxed themselves in by selecting a discount rate before determining liability and damages. This is not "pure speculation" (Opp. 28)—respondents do not contest that the arbitrators declared the discount rate before the contract terminated. And petitioner does not argue that the arbitrators heard no evidence on the discount rate (Opp. 25) but rather that they plucked the FPC rate out of the joint venture agreement without any support and then ignored petitioner's demonstration that use of the FPC rate necessarily inflated damages beyond the legal maximum.[1]

Respondents devote but a short paragraph (at 28) to petitioner's showing that this central contradiction compromises the award. They call the imposition of a legally impermissible discount rate a "factual finding" and "not by any stretch of the imagination a manifest disregard of law." This naked assertion confirms respondents' inability to show how such a discount rate comports with the law. It is not enough that the arbitrators may have taken risk "into account" (*ibid.*). They were *legally required* to distinguish relative risks in adopting a discount rate, especially with hundreds of millions of dollars at stake. Respondents' final defense of the ordered rate (at 29-30)—that it fell between the two parties' estimates—does not speak to whether the arbitrators disregarded governing law in imposing it.

CONCLUSION

The petition for a writ of certiorari should be granted.

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[1] Respondents contend (at 5, 26 n.14) that petitioner's expert favored a discount rate between 9.6% and 12.6%. In fact, the cited testimony addressed only the cost of capital, a mere component of the discount rate. R3951-52. He testified that "[t]he minimum discount rate applicable to a venture of this type is 19.1 percent." R4134.

Respectfully submitted.

WILLIAM H. KNULL, III
TIMOTHY J. TYLER
Mayer, Brown, Rowe & Maw LLP
700 Louisiana Street
Houston, TX 77002
(713) 221-1651

JEFFREY W. SARLES
Counsel of Record
WILLIAM H.J. HUBBARD
Mayer, Brown, Rowe & Maw LLP
190 South LaSalle Street
Chicago, IL 60603
(312) 782-0600